In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-5741

TOPSY'S INTERNATIONAL, INC., JERRY D. BERGER, JAMES T. HOUSE and HARRY NUELL,
Petitioners,

vs.

ROBERT SEIFFER, et al.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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To: The Honorable, The Chief Justice and The Associate Justices of the Supreme Court of the United States

The Petitioners, Topsy's International, Inc., Jerry D. Berger, James T. House and Harry Nuell pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit filed in these proceedings on July 28, 1975.

A timely filed Petition for Rehearing was overruled by the Court of Appeals.

OPINIONS BELOW

The opinion of the United States District Court for the District of Kansas granting a class action is reported at 64 F.R.D. 713 (1974) and appears in the Appendix to this Petition as Appendix A.

The judgment decreeing the action maintainable as a class action appears in the Appendix as Appendix B.

The order of the United States Court of Appeals for the Tenth Circuit denying an appeal pursuant to 28 U.S.C. 1292(b) appears in the Appendix to this Petition as Appendix C.

The order denying a Petition for a Rehearing En Banc on the order denying appeal pursuant to 28 U.S.C. 1292(b) appears in the Appendix to this Petition as Appendix D.

The opinion and order of the United States Court of Appeals for the Tenth Circuit to be reviewed was entered on July 28, 1975 and appears in the Appendix to this Petition as Appendix E. The opinion is as yet unreported.

The order of the United States Court of Appeals for the Tenth Circuit denying the Petition for Rehearing and the Petition for Rehearing En Banc was filed on August 26, 1975 and appears in the Appendix to this Petition as Appendix F.

The order denying a Stay of Mandate was issued by the United States Court of Appeals for the Tenth Circuit on September 10, 1975 and appears in the Appendix to this Petition as Appendix G.

JURISDICTION

The opinion and order of the United States Court of Appeals for the Tenth Circuit dismissing Petitioners' appeal from a judgment of the United States District Court for the District of Kansas which granted a class action pursuant to Rule 23, Fed.R.Civ.Proc., was entered on July 28, 1975. The Petition for Rehearing filed on August 11, 1975 and the Petition for Rehearing En Banc filed on August 8, 1975 were denied on August 26, 1975. The Court of Appeals denied a Motion for Stay of Mandate on September 10, 1975. Jurisdiction of this Court is invoked pursuant to 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Should not a District Court's order granting a class action, which on its face modifies the substantive law so as to eliminate the requirement of proof of certain elements of the claims of prospective class members for the sole purpose of conforming to the procedural requirements of Rule 23, Fed.R.Civ.Proc., be a final judgment for purposes of appeal within the meaning of 28 U.S.C. 1291 under the Supreme Court's opinions in *Eisen* v. *Carlisle and Jacquelin*, 417 U.S. 156 (1974) and *Cohen* v. *Beneficial Loan Corp.*, 337 U.S. 541 (1949) where such order operates to deny Petitioners their right to trial by jury in contravention of the Seventh Amendment to the Constitution of the United States with respect to the substantive issues eliminated as elements of the claims?

2. Whether the opinion of the United States Court of Appeals for the Tenth Circuit holding that orders of the District Court granting class actions are not appealable

under the circumstances of this case directly conflicts with the opinions of the United States Court of Appeals for the Second Circuit in *Herbst* v. *International Telephone and Telegraph Corp.*, 495 F.2d 1308 (2nd Cir. 1974) and *Eisen* v. *Carlisle and Jacquelin*, 479 F.2d 1005 (1973) so that confusion exists with regard to the circumstances under which a court of appeals should supervise and review orders entered by the district courts granting class actions pursuant to Rule 23, Fed.R.Civ.Proc.

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

Fifth Amendment to the Constitution of the United States

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence (sic) to be twice put in jeopardy of life or limb, nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation.

Seventh Amendment to the Constitution of the United States

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury shall

be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

15 U.S.C. 77q

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments or transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in Section 77c of this title shall not apply to the provisions of this section.

15 U.S.C. 78j

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

28 U.S.C. 1291

The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court.

28 U.S.C. 2072

The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions, including admiralty and maritime cases,

and appeals therein, and the practice and procedure in proceedings for the review by the courts of appeals of decisions of the Tax Court of the United States and for the judicial review or enforcement of orders of administrative agencies, boards, commissions, and officers.

Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution.

Such rules shall not take effect until they have been reported to Congress by the Chief Justice at or after the beginning of a regular session thereof but not later than the first day of May, and until the expiration of ninety days after they have been thus reported.

All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect. Nothing in this title, anything therein to the contrary notwithstanding, shall in any way limit, supercede, or repeal any such rules heretofore prescribed by the Supreme Court.

Rule 23, Federal Rules of Civil Procedure

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to be Maintained; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b) (3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivision (b) (1) or (b) (2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b) (3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c) (2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

17 C.F.R. Sec. 240.10(b-5)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

This action was brought by Respondents alleging violations of the Federal Securities Laws, 15 U.S.C. Sec. 77q(a), 78j(b) and 17 C.F.R. Sec. 240.10(b-5) against Petitioners and others alleging that they made misstatements of material facts or omitted to state material facts in twenty-eight separate documents published over an eighteen-month period including annual reports, letters to shareholders, newspaper releases and a prospectus issued in connection with a public offering on February 4, 1969 of securities of Topsy's International, Inc. Respondents seek to bring the action not only on their own behalf, but also on behalf of all purchasers of Topsy's debentures during the period of February 4, 1969 to March 10, 1970 and all purchasers of Topsy's common stock from September 28, 1968 to March 10, 1970. Although the last purchase of a Topsy's security by any Respondent was on August 1, 1969, the litigation was not commenced until November 11, 1971. The Kansas statute of limitations, K.S.A. 60-513(3), with its two year limitation period measured from the date of discovery of the alleged fraud, is applicable to the Respondents' claims under the Federal Security Laws.

Pursuant to its opinion, the District Court of June 24, 1974 ordered the action to proceed as a class action as provided by Rule 23, Fed.R.Civ.Proc. The District Court in ordering that the action proceed as a class action held that the issue of the due diligence of the plaintiffs in bringing the action was "an issue for the trier of fact" and that "if each of the members of the prospective class were required to prove his or her due diligence in discovering the alleged fraud, the individual questions would indeed predominate over the common ones". In order to make the action suitable for class action treatment, the Court modified the substantive law and fashioned an "objective" test of due diligence holding that otherwise the Court would be faced with examining the subject intent of each class member and otherwise a class action would never be feasible. (Appendix A)

At the time it ordered the action proceed as a class action, the District Court certified its decision to the Tenth Circuit Court of Appeals pursuant to the provisions of 28 U.S.C. 1292(b). (Appendix B) Petitioners' timely Notice of Appeal pursuant to 1292(b) was denied by the Tenth Circuit on September 19, 1974. (Appendix C) A Petition for Rehearing En Banc was denied by the Court of Appeals on October 18, 1974. (Appendix D)

Petitioners also filed an appeal with the Tenth Circuit Court of Appeals under the provisions of 28 U.S.C. 1291. On July 28, 1975, the Court of Appeals entered its order holding that the District Court's class action order was not a final judgment appealable pursuant to Sec. 1291. (Appendix E) A Motion for Rehearing and a Motion for Rehearing En Banc of that decision were denied by the Court on August 26, 1975. (Appendix F) The Court of Appeals denied a Motion for Stay of Mandate on September 10, 1975. (Appendix G)

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT

1. The District Court's Order Granting a Class Action Which on Its Face Modified the Substantive Law So As to Eliminate the Requirement of Proof of Certain Elements of the Claims of Prospective Class Members for the Sole Purpose of Conforming to the Procedural Requirements of Rule 23, Fed.R.Civ.Proc., Is a Final Judgment for Purposes of Appeal Within the Meaning of 28 U.S.C. 1291 Under the Supreme Court's Opinions in Eisen v. Carlisle and Jacquelin, 417 U.S. 156 (1974) and Cohen v. Beneficial Loan Corp., 337 U.S. 541 (1949) Where Such Order Operates to Deny Petitioners Their Right to Trial by Jury in Contravention of the Seventh Amendment to the Constitution of the United States and Due Process in Contravention of the Fifth Amendment to the Constitution of the United States With Respect to the Substantive Issues Eliminated As Elements of the Claims.

The Order of the District Court, which the Tenth Circuit refused to review as failing to be appealable pursuant to 28 U.S.C. 1291, clearly falls within "that small class (of orders) which finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated". *Cohen* v. *Beneficial Loan Corp.*, 337 U.S. 541, 69 S.Ct. 1221, 93 L.Ed. 1528 (1949).

Rule 23, Fed.R.Civ.Proc. is a procedural device which cannot alter substantive rights. *Snyder* v. *Harris*, 394 U.S. 332 (1969); *Sibbach* v. *Wilson & Co.*, 312 U.S.

1 (1941); *Eisen* v. *Carlisle and Jacquelin,* 479 F.2d 1005, 1014 (1973). When the District Court, in contravention of the Rules Enabling Act, 28 U.S.C. 2072, modified the substantive law of the claims solely to accommodate the dictates of the procedural rule and in so doing impaired Petitioners' constitutional rights, the order became "too important to be denied (immediate) review". That the District Court modified the substantive law to meet the requirements of Rule 23 is conceded in the District Court's opinion. The District Court held, 64 F.R.D. 714, 719 that:

> "If each of the members of the prospective class were required to prove his or her due diligence in discovering the alleged fraud, the individual questions would indeed predominate over the common ones. But we believe a more objective standard could and should be applied; otherwise a class action would never be feasible in a case such as this."

The Rules Enabling Act, 28 U.S.C. 2072, is unequivocal in its command that "Such rules (of civil procedure) shall not abridge, enlarge or modify any substantive rights and shall preserve the right to trial by jury . . .". The District Court by fashioning an "objective standard" whereby proof of individual due diligence is eliminated, has denied to Petitioners the right to trial by jury on the factual issue of whether the particular circumstances pertaining to each claimant bars his claim because of a lack of due diligence. Petitioners seek to show that as to each, regardless of the testimony of named plaintiffs, each knew of facts claimed to have been omitted or did not rely on alleged misrepresentations. The modification of the substantive law affects a denial of defenses Petitioners might otherwise raise denying them their constitutional right of due process. The District Court's order creates a double standard as between named plaintiffs who would

be available to be cross-examined about their due diligence as opposed to absent class members who could not be confronted on the issue.

As noted by this Court, appellate review is restricted to "final decisions" to avoid "piecemeal appellate disposition of what is, in practical consequence, but a single controversy". *Eisen* v. *Carlisle and Jacquelin,* 417 U.S. 156, 170 (1974). The decision which the Tenth Circuit declined to hear was not "merely a 'step toward final disposition of the merits of the case' ", but the clearly collateral issue of whether the District Court was to be allowed to proceed in violation of the Rules Enabling Act. This question turns not one iota on the merit, or lack thereof, inherent in the claims, but rather solely on the question of law decidable without reference to the facts in issue.

The question presented to the Court of Appeals was simply whether the District Court in its desire to utilize Rule 23 had abridged Petitioners' rights to enable the theory of the action to fit the parameters of the procedural tool. To decide this question, decides the totally independent issue of whether a claim can be asserted on behalf of absent class members. This the Tenth Circuit clearly misapprehended. The Court of Appeals, in deciding the question held that ". . . the ultimate issue sought to be appealed is whether the class action authorized by the order is appropriately manageable". (Appendix E) This is not at all the issue. The District Court conceded that the action could not proceed as a class action without the creation of an "objective standard" so that the Court would be "freed from the overwhelming task of examining the subjective intent of each class member". 64 F.R.D., at 719. Thus, the issue which Petitioners seek reviewed is whether, in light of 28 U.S.C. 2072, the District Court

can modify the substantive law to free itself from an "overwhelming task" where the modification works to the clear detriment of a party to the litigation. Petitioners say it cannot and say that the matter was ripe for review by the Court of Appeals.

The question presented to the Court of Appeals is not part of the "single controversy", but is the clearly separable and collateral issue of the right of the District Court to modify substantive rights to accommodate a procedural rule. This, like the District Court's allocation of the cost of notice in *Eisen,* is "but one aspect" of the resolution of the Rule 23 question. 417 U.S., at 172. The question was determined with finality by the District Court and thereby became a final decision under Sec. 1291.

As in *Cohen,* where the District Court settled a question of state law with regard to security for costs, the District Court in this action has settled the law of the case. By so doing, the District Court has settled a claim of right under circumstances where substantive law may not be modified, so that its order falls within "that small class" of orders which become appealable pursuant to Sec. 1291.

2. The Opinion of the Tenth Circuit Holding That Orders of the District Court Granting Class Actions Are Not Appealable Under the Circumstances of This Case Directly Conflicts With the Opinion of the Second Circuit in Herbst v. International Telephone and Telegraph Corp., 495 F.2d 1308 (1974) and Eisen v. Carlisle and Jacquelin, 479 F.2d 1005 (1973) So That Confusion Exists With Regard to the Circumstances Under Which a Court of Appeals Should Supervise and Review Orders Entered by the District Courts Granting Class Actions Pursuant to Rule 23, Fed.R.Civ.Proc.

The Tenth Circuit Court of Appeals, in its holding that the District Court's order was not appealable, applied an interpretation of the "three-prong test for Sec. 1291 appealability" enunciated by the Second Circuit in *General Motors Corp.* v. *City of New York,* 501 F.2d 639 (2nd Cir. 1974). In doing so, the Tenth Circuit ignored and held contrary to the clear guidelines given by the Second Circuit in its two leading opinions which deal with the appeal of the grant of a class action, *Herbst* v. *International Telephone and Telegraph Corp.,* 495 F.2d 1308 (1974) and *Eisen* v. *Carlisle and Jacquelin,* 479 F.2d 1005 (1973). The Second Circuit in that *Eisen* opinion, n.1, explaining its rationale for retaining jurisdiction on remand of the action to the District Court, adopted a philosophy of appealability that "will afford equality of treatment as between plaintiffs and defendants". See also *Korn* v. *Franchard Corp.,* 443 F.2d 1301 (2nd Cir. 1971). The Second Circuit, acknowledging the pragmatic approach to the collateral order doctrine suggested by the Supreme Court in *Cohen,* recognized the irreparable harm engendered by the delay in appellate review of an improvidently granted class action. As noted by the *Eisen* Court, an order sustaining a class action both "clearly involves issues 'fundamental to the

further conduct of the case' " and is separate from the issues on the merits. The Court realistically recognized that the "irreparable harm to a defendant in terms of time and money spent in defending a huge class action when an appellate court may years later decide such action does not conform to Rule 23, is evident". 479 F.2d at 1007, n.1. In its subsequent decision in *Herbst*, the Second Circuit further elaborated on the policy considerations that speak for prompt appellate review of class action orders, stating, 495 F.2d at 1313:

> "We believe that in the exercise of our supervisory powers over the administration of justice in the district courts it is desirable for us to review orders authorizing class actions before the parties and the district courts expend large amounts of time and money in managing them. Candor compels us to add that a class action had been improper after the district court and the parties had expended much time and resources although we might have had serious doubts if we had reviewed the question at the inception of the action. Judicial efficiency requires that courts have spent considerable time, effort, and money, on such actions. Reviewing order allowing class actions to proceed would determine issues 'fundamental to the further conduct of the case', *United States* v. *General Motors Corp.*, 323 U.S. 373, 377, 65 S.Ct. 357, 89 L.Ed. 311 (1945), and would constitute a most effective way of exercising our supervisory powers."

The court goes on to hold that clearly, it has jurisdiction of such an appeal. 495 F.2d, at 1313 and n.10.

The rationale of the Tenth Circuit in denying Petitioners' right of appeal not only is in direct conflict with the decisions of the Second Circuit, but moreover takes

an unrealistic view of the impact of the class action order.[1] The Tenth Circuit equates "fundamental to the conduct" with the continued viability of the action finding that named plaintiffs, having substantial claims, will continue to press them whether or not the action proceeds as a class action. This restrictive view ignores the effect of the class action order. Creating a class action draws into the proceedings thousands of persons who have otherwise evidenced no interest in litigating with the defendants. It creates immense administrative burdens on the District Court. It forces a defendant to risk staggering liability or settle regardless of the merit of the claims. No one who has participated in a class action can truthfully say it is not fundamental to the further conduct of the litigation.

The impact of the litigation in time, money and the intangible damage caused by the suit can never be recouped so that irreparable harm is the inevitable outcome of an erroneous class order.

The Tenth Circuit founds its decision in part on the theory that the order remains subject to reappraisal and modification by the District Court during the course of the proceedings. (Appendix E) However, the modification of a class order contemplated by Rule 23(c)(1) is that which would arise by virtue of reevaluation of facts emerging from a fuller record, the order having been granted as soon as practicable after commencement of the action. *Advisory Committee Note*, 39 F.R.D. 69, 104.

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1. Petitioners call to the Court's attention that two Second Circuit Opinions have held that orders granting class actions were not appealable under the particular circumstances of each case. *General Motors Corp.* v. *City of New York*, 501 F.2d 639 (2nd Cir. 1974); *Parkinson* v. *April Industries, Inc.*, ____ F.2d ____ (1975), 75 CCH Sec.L.Rep., para. 95,227. Neither decision overrules the policy considerations of either *Eisen* or *Herbst*.

The District Court order which Petitioners seek reviewed has two vitally different characteristics. First, the error complained of turns solely on a question of law which will not be affected by the facts developed by discovery. Secondly, even if discovery were to aid the resolution, the District Court's decision came at a time two and one-half years after the commencement of the action when the Court had available to it hundreds of pages of testimony and hundreds of documents in the form of a record designated by the parties. If the Court of Appeals considered the order a conditional order granted at the onset of the litigation, it clearly misapprehended the circumstances.

While it might be unreasonable to argue that all class action orders should be automatically appealable, it is with equal force unreasonable to argue that the appellate courts should take a limited part in the review of class action decisions.[2] The conflict between the policy enunciated by the Second Circuit and that of the Tenth Circuit is highlighted by the circumstances of this case where the error of the District Court is clearly apparent from the face of its order and its holding on the substantive law is in direct conflict with holdings of other district courts

2. The District Court in this action thought its decision would be reviewed. The District Court not only certified the ruling for appeal pursuant to 28 U.S.C. 1292(b) which was denied by the Court of Appeals, but also commented in the record during pretrial proceedings:

> "I will tell you, now, if I grant it, I intended to frame it so there is no question that it's an appealable order. The Tenth Circuit Court, though, has been liberal in taking these. Our Wilcox case went up where we denied it, they took it on up, interlocutory, and I wouldn't anticipate any problem, but I did think in view of the Eisen case that there would be no problem in framing the order, if I permit it, that it could be—go up as a matter of course." (R. Pretrial Transcript, Vol XX, pp. 58-59)

in the circuit so that there now exists conflict among the districts with the Tenth Circuit.[3]

The overwhelming impact of Rule 23 on both the litigants and the District Court cannot be overlooked. The decisions of the Second Circuit with regard to the degree of responsibility of the appellate courts to participate in the class action decision is clearly in conflict with that of the Tenth Circuit as enunciated in this case.

CONCLUSION

The Petition should be granted for the reasons that the opinion sought to be appealed was clearly a final order in its particular circumstances and further because there exists a clear conflict between the Courts of Appeals as to the circumstances when orders granting class actions should be reviewed.

Respectfully submitted,

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3. *Hickman, et al.* v. *Groesbeck, et al.*, No. C252-72, (D.C. Utah, December 18, 1974), which appears in the Appendix as Appendix H, holds that in a private right of action under Rule 10b-5, "In this Circuit it is clear that materiality, scienter, reliance and causation and damages in connection with a misrepresentation or omission must be shown."

APPENDIX

APPENDIX A

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS

No. KC-3435

Robert Seiffer, et al.,
Plaintiffs,

vs.

Topsy's International, Inc., et al.,
Defendants.

Memorandum and Order

Plaintiffs filed their original complaint alleging certain securities act violations, both federal and state, on November 11, 1971. Since that time, plaintiffs have filed several amended complaints, additional parties defendant have been added, cross-claims and third-party complaints have been filed, and extensive discovery has been conducted. All of this is by way of prefacing the issue we reach here: whether or not the plaintiffs should be allowed to maintain this action as a class action pursuant to Rule 23 of the Federal Rules of Civil Procedure.

The court has already denied a motion for an order declaring this action not a class action. (Memorandum and Order of October 2, 1972, p. 8.) Our ruling was conditioned upon (1) a showing that plaintiffs' discovery of the alleged fraud is consistent with the requisite diligence; and (2) assuming such a showing is made, that plaintiffs amend their complaint to define clearly and with particu-

larity the class of plaintiffs they seek to represent. We believe that the amendments to plaintiffs' complaint have satisfied the second condition; hence, we now turn to consider the due diligence issue.

Plaintiffs essentially allege that defendants participated in a scheme to defraud the class they seek to represent in violation of §17(a) of the Securities Act of 1933 [15 U.S.C. §77q(a)] and of §10(b) of the Securities Exchange Act of 1934 [15 U.S.C. §78j(b)] and Rule 10b-5 promulgated thereunder (17 C.F.R. §240.10b-5). We have already determined that the statute of limitations in this private suit for damages under Rule 10b-5 is the Kansas statute of limitations for fraud, K.S.A. 60-513(3), which provides for a two-year period from the date of discovery of the fraud. (Memorandum and Order of October 2, 1972, p. 7.) But the federal tolling doctrine applies in the determination of when plaintiffs, in the exercise of due diligence should have discovered the alleged fraud. *Esplin v. Hirschi,* 402 F.2d 94 (10th Cir. 1968); *deHaas v. Empire Petroleum Company,* 435 F.2d 1223 (10th Cir. 1970). It requires no restatement of the alleged facts of this case and of the relationship of the parties for this court to determine that this is an issue for the trier of fact. Seldom is it possible for such an issue to be determined summarily. *Dzenitz v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 494 F.2d 168 (10th Cir. 1974). The court is therefore satisfied that the conditions previously imposed have been met insofar as is possible at this time. Our ruling in this regard is applicable to defendant Touche, Ross & Company even though it was not joined as a defendant until October 17, 1973, when plaintiffs' third amended complaint was filed.

In addition to the conditions imposed by the court, Rule 23 establishes several prerequisites for the maintenance of a class action. Firstly, the alleged class of defrauded purchasers must be so numerous that joinder of all members is impracticable. Here the number of persons who purchased Topsy's securities, both common stock and debentures, in the February 4, 1969, offering alone, while difficult to determine with any degree of certainty, may well exceed 1,000. Thus the court believes that this first prerequisite has been satisfied.

Secondly, there must be questions of law or fact common to the class. Inasmuch as the alleged scheme to defraud was designed to inflate the price of Topsy's securities, all of the class members who purchased those securities during the relevant period of time would presumably have been affected, albeit in varying degrees. We will consider later in this memorandum whether the common issues relating to the alleged fraud predominate over individual ones. For now, we conclude that there are common questions of law and fact.

Thirdly, the claims or defenses of the representative parties must be typical of the claims or defenses of the class. This requirement appears to duplicate other provisions of the rule, *i.e.,* the common questions and representative party provisions. 3B Moore's Federal Practice ¶23.06-2. In view of our rulings on these other provisions, we hold that the claims of the plaintiffs are typical of those of the class of purchasers who have allegedly been defrauded by defendants' scheme.

Finally, the representative parties must fairly and adequately protect the interests of the class. Plaintiffs seek to represent a class of purchasers of the common stock of defendant Topsy's International from September 28, 1968, to March 10, 1970, and purchasers of the debentures of Topsy's from February 4, 1969 (when they were first offered), to March 10, 1970. These dates roughly coincide

with when Topsy's shareholders would have received letters from the company's management announcing the acquisition of SaxonS Sandwich Shoppes, Inc., in September 1968, and announcing the losses from the repurchase of SaxonS units in March 1970. It was during this period of time that defendants are alleged to have maintained an inflated price for Topsy's securities through a fraudulent scheme whereby defendants' public statements painted an overly optimistic picture of the SaxonS operation, when in truth there was no reasonable basis for making such statements. Since the named plaintiffs purchased stock and debentures during this period, we see no reason why they cannot fairly and adequately protect the interests of all those who purchased in that span of time. Even though defendants contend these plaintiffs' purchases were not exactly coextensive with the proposed class, we are of the opinion that there is no inconsistency with the interests of other members of the class who purchased at other times during the relevant period which would prevent the named plaintiffs from representing the whole class. Defendants also specifically challenge the willingness and ability of certain of the named plaintiffs to represent the class, and, further, the ability of the plaintiffs' attorneys to represent the class because of an alleged conflict of interest with a third party defendant. We do not believe these matters of sufficient import to deny certification of the class. We hold that plaintiffs have met all the prerequisites of Rule 23(a).

In addition to the prerequisites of subdivision (a) of Rule 23, plaintiffs must satisfy one of the sections of subdivision (b). Plaintiffs contend that this action falls within (b)(3):

> "the court finds that the questions of law or fact common to the members of the class predominate

> over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action."

Defendants voice strenuous objections to certification of a (b)(3) type class. Because the list of matters pertinent to the court's findings under (b)(3) is non-exhaustive (Notes of the Advisory Committee Regarding the 1966 Amendment to Rule 23), defendants raise issues which, for the most part, are unique to this kind of 10b-5 action.

Defendants first contend that reliance is a necessary element in a 10b-5 action and that this issue is primarily an individual one, citing in particular *Financial Industrial Fund, Inc. v. McDonnell Douglas Corp.*, 474 F.2d 514 (10th Cir. 1973). The element of reliance in 10b-5 cases is usually considered part of the larger issue of causation. Thus, in a case very similar to this, the United States Supreme Court held:

> "Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them im-

portant in the making of this decision. (*Citations omitted.*) This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact. (*Citation omitted.*)" *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 153-54, 31 L.Ed.2d 741, 92 S.C. 1456 (1972).

We regard the *Affiliated Ute* case as controlling here. See *Rochez Bros., Inc. v. Rhoades,* 491 F.2d 402 (3rd Cir. 1974); *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 42 L.W. 2544, April 23, 1974 (2nd Cir.); *Dorfman v. First Boston Corp.,* 42 L.W. 2552, April 30, 1974 (E.D.Pa.); *Werfel v. Kramarsky,* 61 F.R.D. 674 (S.D.N.Y. 1974). Defendants err in thinking that the Tenth Circuit in the *Financial Industrial Fund* case implied any different standard than that set forth in *Affiliated Ute,* where the Supreme Court overruled the Tenth Circuit's restrictive interpretation of the reliance issue in a 10b-5 case. We therefore conclude that reliance is not a bar to plaintiffs' maintenance of a class action.

Defendants next contend that there are material differences in the alleged misrepresentations which preclude class action treatment of this suit. On the other hand, it has been suggested that a fraud perpetrated on numerous persons by the use of similar misrepresentations is an appealing situation for a class action. (Notes of the Advisory Committee Regarding the 1966 Amendment to Rule 23.) Despite the fact that the alleged misrepresentations regarding the SaxonS operation appeared in different publications at different times, they all emanated from the defendants as part of the alleged fraudulent scheme to maintain an inflated price for Topsy's securities, and in the opinion of the court they are interrelated and cumulative. Moreover, plaintiffs are primarily alleging a complete failure to disclose material facts—which default was necessarily common to all members of the proposed class. *Esplin v. Hirschi, supra.* Thus we believe the common issues predominate over individual ones insofar as the alleged misrepresentations and omissions are concerned. Parenthetically, we would observe that cases which the defendants have cited such as *Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 482 F.2d 880 (5th Cir. 1973), are inapposite because they involve oral misrepresentations.

Defendants further contend that the limitations issue makes this case unsuitable for class action designation. The court has previously expressed some misgivings about the propriety of maintaining a class action because of this very issue. Though plaintiffs have convinced the court that their due diligence in discovering the alleged fraud is an issue for the trier of fact (*supra,* p. 2), we must now inquire whether there must be an individual determination of the due diligence issue which would predominate over questions common to the class. If each of the members of the prospective class were required to prove his or her due diligence in discovering the alleged fraud, the individual questions would indeed predominate over the common ones. But we believe a more objective standard could and should be applied; otherwise a class action would never be feasible in a case such as this. The standard should be whether a reasonable investor, in light of the facts existing at the time of the nondisclosure and in the exercise of due care, would have been entitled to receive full disclosure from the party charged and would have acted differently had the alleged nondisclosure not occurred. *City National Bank of Fort Smith, Ark. v. Vanderboom,* 422 F.2d 221 (8th Cir. 1970). Thus the due diligence issue, which in a case such as this is really an extension of the issue of causation in fact, can be determined by resorting to the same "reasonable investor" test

employed by the Supreme Court in the *Affiliated Ute* case, *supra*. It is only by using such an approach that the court is freed from the overwhelming task of examining the subjective intent of each class member. *Grad v. Memorex Corporation*, CCH Fed. Sec. L. Rep. ¶94,029 (N.D.Cal. 1973). We conclude that plaintiffs have satisfied the requirement that the common issues predominate over individual ones.

Finally, we must decide whether a class action is superior to other available methods for the fair and efficient adjudication of the controversy. It has been our view that the class action appears particularly suitable for this kind of shareholder suit. (Memorandum and Order of October 2, 1972, p. 8.) While we are well aware of the potential burden upon the court and jury posed by the maintenance of a class action, our primary task is to see that the securities laws are enforced to protect investors from fraud of whatever magnitude as intended by Congress. *Securities and Exchange Commission v. International Chemical Development Corp.*, 469 F.2d 20 (10th Cir. 1972). Furthermore, it has been said that, "the ultimate effectiveness of [the security anti-fraud laws] may depend on the applicability of the class action device." Loss, Securities Regulation, 2d Ed. 1961, p. 1819. Following Judge Hill's directive in *Esplin v. Hirschi, supra*, that if there is to be any error it should be committed in favor of allowing the class action, we hold that the class action is superior to other available methods for the fair and efficient adjudication of this controversy.

The plaintiffs' motion to strike defendants' supplemental brief has been rendered moot by the court's order herein. The issue of the possible liability of defendant Touche, Ross is not, in our view, properly raised in connection with the class action issue and will not be treated here.

CONCLUSION

The court finds that the requirements of Rule 23 have been met and that this action should proceed as a class action. The court hereby certifies a class of purchasers who bought Topsy's common stock from September 28, 1968, to March 10, 1970, and who bought Topsy's debentures from February 4, 1969, to March 10, 1970, and who suffered a loss as a result of the defendants' alleged misrepresentations and omissions. Notice shall be given to the class pursuant to Rule 23(c)(2), with costs to be borne by plaintiffs. *Eisen v. Carlisle & Jacquelin*, ... U.S. ....., 42 L.W. 4804 (May 28, 1974). Our ruling applies only to Count I of plaintiffs' third amended complaint; Count II, the Kansas claims which have not been discussed in this memorandum, shall proceed individually. Plaintiffs' counsel are directed to prepare and submit a journal entry of judgment reflecting the conclusion reached here.

IT IS SO ORDERED.

Dated this 27th day of June, 1974, at Kansas City, Kansas.

/s/ Earl E. O'Connor
United States District Judge

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS

No. KC-3435

Robert Seiffer, et al.,
Plaintiffs,

vs.

Topsy's International, Inc., et al.,
Defendants.

JUDGMENT DECREEING THE ACTION MAINTAINABLE AS A CLASS ACTION

This matter having been fully briefed by the parties including designations of deposition testimony and documents, on plaintiffs' motion for an order declaring the instant action maintainable as a class action pursuant to Rule 23(c)(1) of the Federal Rules of Civil Procedure, with oral argument being held on June 13, 1974; and,

The court having entered a Memorandum and Order on June 27, 1974, determining that all requirements of Rule 23 have been met by plaintiffs and that Count I of plaintiffs' Third Amended Complaint is to be maintained as a class action under Rule 23(b)(3) for and on behalf of plaintiffs and all purchasers of the common stock of Topsy's International, Inc. from September 28, 1968, to March 10, 1970, and all purchasers of Topsy's Convertible Subordinated Debentures due 1984, from February 4, 1969, to March 10, 1970, who suffered a loss as a result of defendants' alleged misrepresentations and omissions, against all of the defendants; it is hereby

ORDERED that Count I of plaintiffs' Third Amended Complaint is to be maintained as a class action under Rule 23(b)(3) of the Federal Rules of Civil Procedure on behalf of a class comprised of plaintiffs and all other purchasers of (1) Topsy's common stock from September 28, 1968, to March 10, 1970, and (2) Topsy's debentures from February 4, 1969, to March 10, 1970, who suffered a loss as a result of defendants' alleged misrepresentations and omissions.

It is further

ORDERED that notice shall be given to the class members pursuant to Rule 23(c)(2) with costs to be borne by plaintiffs.

It is further

ORDERED that the Memorandum and Order of June 27, 1974 involves controlling questions of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation.

IT IS SO ORDERED.

Earl E. O'Connor
United States District Judge

July 26, 1974

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 74-8091
No. 74-8094

September Term, 1974

Robert Seiffer, et al
Respondents,

vs.

Topsy's International, Inc., et al.,
Petitioners,

and

Touche Ross & Co.,
Petitioner,

vs.

Robert Seiffer, et al.,
Respondent.

Appeal from the United States District Court
for the District of Kansas

Before Honorable Oliver Seth, Honorable William J. Holloway, Jr., and Honorable William E. Doyle, Circuit Judges

This matter comes on for consideration of petitions for leave to appeal under §1292(b) of Title 28, U.S.C.

Upon consideration whereof, it is ordered that the petitions for leave to appeal are denied.

September 19, 1974

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Misc. No. 74-8091

September Term, 1974

Robert Seiffer, et al.,
Plaintiffs-Respondents,

vs.

Topsy's International, Inc., et al.,
Defendants-Petitioners.

Appeal from the United States District Court
for the District of Kansas

This matter comes on for consideration of the petition for rehearing and suggestion for rehearing en banc filed by the petitioners in the captioned case.

Upon consideration whereof, the petition for rehearing is denied by Circuit Judges Seth, Holloway and Doyle, to whom the cases were argued and submitted.

The petition for rehearing having been denied by the original panel to whom the cases were argued and submitted and no member of the panel nor judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

October 18, 1974

APPENDIX E

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 74-1711

No. 74-1712

No. 74-1713

Robert Seiffer, et al.,
Plaintiffs-Appellees,

vs.

Topsy's International, Inc.,
Defendants-Appellants.

Appeal from the United States District Court
for the District of Kansas

Before Murrah, Barrett and Doyle, Circuit Judges.

Murrah, Circuit Judge.

OPINION

Topsy's International, Inc., and its accountants Touche Ross & Co. bring this §1291 appeal from a judgment certifying a class action in a federal[1] securities fraud suit against them and two other defendants not parties to this appeal.[2] The trial court held and all the parties appar-

1. Only federal claims under 15 U.S.C. §§ 77q(a), 78j(b) and 17 C.F.R. § 240.10b-5 were certified to be maintainable in the class action. The complaint also contained allegations under Kansas state securities laws, which are to proceed individually and are not components of the case being reviewed here.

2. Topsy's underwriters and lawyers are also named as defendants, but they do not join this appeal of the certification of the class.

ently acknowledge that the Kansas two-year statute of limitations is applicable as a defense to the action, unless it can be shown under the federal tolling doctrine[3] that the action was brought within two years of the time when plaintiffs by due diligence would discover or should have discovered the alleged fraud. In holding that the plaintiffs and the defined class meet all the requirements of Fed. R. Civ. P. 23(b) (3), the trial judge concluded that neither the federal securities laws nor the federal tolling doctrine require each class member to prove individual due diligence in discovering the fraud; that, instead, the applicable test is the "objective standard" of whether and when a "reasonable investor" would have discovered the fraud; and that common questions of law and fact thus predominate. Appellants contend that such an objective standard is not the law; that due diligence must be proved individually, making a class action unmanageable; and that we should therefore reverse the order certifying the class. We have previously held that the same order was not appealable under §1292(b). (Order of September 19, 1974; petition for rehearing en banc denied by Order of October 18, 1974.) We now hold that the order is not appealable under §1291. This means that, as the record presently stands, the case will be tried as structured by the order certifying the class and that the error in that order, if any, must await review until final decision on the merits.

According to the plaintiffs' allegations, the defendants maintained an artificially inflated price for Topsy's securities by means of misleading annual reports, letters to

3. "[W]here the party injured by the fraud remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud is discovered . . . ." Bailey v. Glover, 88 U.S. 342 (1874), quoted in deHaas v. Empire Petroleum Co., 435 F.2d 1223, 1226 (10th Cir. 1970).

shareholders, newspaper releases, and purportedly independent research reports, regarding Topsy's financial status and prospects, particularly as to its acquisition of Saxons Sandwich Shoppes, Inc. These reports of Saxons actual and potential profitability were allegedly disseminated, even though Saxons was declining and was ultimately closed by Topsy's at a great loss. The trial court's order gave the named plaintiffs the right to represent a class defined as all the damaged purchasers of Topsy's common stock from September 28, 1968, when each shareholder received the same letter from Topsy's favorably announcing its acquisition of Saxons, and all damaged purchasers of Topsy's debentures from February 4, 1969, until March 10, 1970, when the losses from the Saxons operation were revealed in a letter to all shareholders.

Generally, appealability under §1291 is limited to final judgments reached after trial on the merits. An order allowing or disallowing a class action may be assigned as error at that time. Esplin v. Hirschi, 402 F.2d 94 (10th Cir. 1968). We have expressed reluctance to grant immediate review of orders granting or denying class status, in view of the fact that such an order is subject to amendment as the trial proceeds. Fed. R. Civ. P. 23(c)(1) and the Notes thereto. In Gerstle v. Continental Airlines, Inc., 466 F.2d 1374, 1377 (10th Cir. 1972), we held that an order disallowing the class status previously granted was non-appealable under §1291, since the trial court had expressed its openness to further consideration and modification of the order. See also Gold Strike Stamp Co. v. Christensen, 436 F.2d 791, 792 n.2 (10th Cir. 1970). Cf., Wilcox v. Commerce Bank of Kansas City, 474 F.2d 336 (10th Cir. 1973) (granting §1292 appealability of an order denying class status).

These cases preceded Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 171 (1973). In that case, the Supreme Court,

giving §1291 "a practical rather than a technical construction," granted appeal from "collateral orders" in a class action before final judgment on the merits. See also Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 546 (1949). In doing so, the Court observed that the determination of finality for purposes of §1291 may pose a close question and should be guided by balancing "the inconvenience and costs of piecemeal review on the one hand and the danger of denying justice by delay on the other." It affirmed the Court of Appeals' jurisdiction to review the district court's order allowing a class action with the condition that the defendants bear 90% of the cost of notice to the class. Expressly declining to decide jurisdiction over the issues of manageability and fluid-class recovery, the Court held that the order was appealable because the allocation of notice costs was a "final disposition of a claimed right which is not an ingredient of the cause of action and does not require consideration with it." See generally, Manual for Complex Litigation, pp. 17-51 (1973). In our case, no claim is made as to the propriety of the allocation of notice costs to the plaintiffs. Rather, the ultimate issue sought to be appealed is whether the class action authorized by the order is appropriately manageable.

Following Eisen III, the Courts of Appeals have undertaken to articulate the guidelines governing the §1291 appealability of a class action order. In denying the appealability of an order granting class standing, in General Motors Corp. v. City of New York, 501 F.2d 639, 644 (2d Cir. 1974), Chief Judge Kaufman reviewed and reaffirmed the Second Circuit's pre-Eisen three-prong test for §1291 appealability: (1) whether the class action determination is fundamental to the further conduct of the case; (2) whether review of that order is separable from

the merits; and (3) whether that order will cause irreparable harm to the defendant in terms of time and money spent in defending a huge class action. The General Motors case distinguished Herbst v. International Telephone and Telegraph Corp., 495 F.2d 1308 (2d Cir. 1974), where §1291 appeal from an order certifying a class action was allowed because the practical viability of the action as well as the defense costs were vastly altered by the order. In that case, the order granting class standing converted the plaintiff from a single individual holding 100 shares to a class of 16,000 shareholders. Cf., Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968), cert. denied, 395 U.S. 977 (1969) (granting §1291 appealability of an order denying class status on "death knell" principle).

In Rodgers v. United States Steel Corp., 508 F.2d 152, 159 (3rd Cir. 1975) (opinion by Judge Gibbons), the court disallowed §1291 appeal from an order postponing class action determination and restricting communications with potential class members by plaintiffs or their attorneys. In this case, the Third Circuit formulated a similar three-prong appealability test: (1) the order must be a final rather than a provisional disposition of an issue; (2) it must not merely be a step toward final disposition of the merits; and (3) the rights asserted would be irreparably lost if review is postponed until final judgment. See also In re Cessna Aircraft Distributorship Antitrust Litigation, White Industries, Inc., v. The Cessna Aircraft Co., No. 74-1563 (8th Cir. June 23, 1975) (denying §1291 appealability of an order granting class status); Williams v. Mumford, 511 F.2d 363 (D.C. Cir. 1975) (denying §1291 appealability of an order denying class status).

In our case, the "fundamental conduct" or viability of the suit does not turn on the class certification. The inclusion of the estimated 4,700 potential class members

will indeed enlarge the stakes in the litigation, but it is not a sine qua non for the further conduct of the suit by the plaintiffs. There is probative evidence on the record that the nine named plaintiffs have substantial personal assets and a total potential recovery of $200,000, and they have manifest an intent to pursue the suit even if denied class status. The order thus does no "irreparable harm" to the defendants. They will be faced with a large and persistent lawsuit whether the class action is allowed or not. Cf. Herbst v. International Telephone and Telegraph, supra, and Eisen III, supra.

Furthermore, the determination of class here is not collateral to the final adjudication of the issues; rather it is an essential "ingredient of the cause of action" and "require[s] consideration with it." The objective standard for proving plaintiff's due diligence was necessarily established by the order; and proof of due diligence is an integral part of the cause of action whether brought individually or as a class because it involves both the right to bring the suit under the statute of limitations and the ultimate right to recover under the securities laws. See note 1, supra; Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-154 (1972).

Both quantitative and qualitative analysis convince us that it would be improper to review this order until the case has proceeded to a final disposition on the merits. Of course, the order remains subject to reappraisal and modification by the trial court during the course of its proceedings, and nothing herein expressed is intended to hinder or limit that process. We hold that at this juncture review of the order certifying the class is jurisdictionally inappropriate.

The appeal is dismissed.

July 28, 1975

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 74-1711
No. 74-1712
No. 74-1713
July Term, 1975

Robert Seiffer, et al.,
Plaintiffs-Appellees,

vs.

Topsy's International, Inc.,
Defendants-Appellants.

Appeal from the United States District Court
for the District of Kansas

Before The Honorable David T. Lewis, Chief Judge, The Honorable Alfred P. Murrah, The Honorable Delmas C. Hill, The Honorable Oliver Seth, The Honorable William J. Holloway, Jr., The Honorable Robert H. McWilliams, The Honorable James E. Barrett and The Honorable William E. Doyle, Circuit Judges

This matter comes on for consideration of the appellants' petitions for rehearing, and suggestions for rehearing en banc filed with the Court on August 8, 1975 and August 11, 1975.

Upon consideration whereof, the petitions for rehearing are denied by Circuit Judges Murrah, Barrett and Doyle to whom the cases were argued and submitted.

The petitions for rehearing having been denied by the original panel to whom the cases were argued and

submitted and no member of the panel nor judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate procedure, the suggestions for rehearing en banc are denied.

August 26, 1975

APPENDIX G

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 74-1711
No. 74-1712

Robert Seiffer, et al.,
Plaintiffs-Appellees,

vs.

Topsy's International, Inc.,
Defendants-Appellants.

Appeal from the United States District Court
for the District of Kansas

Before The Honorable Alfred P. Murrah, Senior Judge, The Honorable James E. Barrett and The Honorable William E. Doyle, Circuit Judges

This matter comes on for consideration of the motion of Appellants for stay of mandate in the captioned cases, and of the various responses thereto.

Upon consideration whereof, it is the order of the Court that the motion for stay of mandate is denied.

September 10, 1975

APPENDIX H

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

No. C 252-72

GRANT A. HICKMAN, STANFORD E. POULSON, BEN M. FISHLER and NEWELL E. WARR,

Plaintiffs,

v.

ARTHUR J. GROESBECK, III, ARTHUR J. GROESBECK ASSOCIATES, INC., a California corporation, GRIFFIN SERVICES CORPORATION, a California corporation, GRIFFIN PROPERTIES CORPORATION, a California corporation, GRIFFIN SECURITIES CORPORATION, a California corporation, GRIFFIN BUSINESS SERVICES CORPORATION, a California corporation, COMPU-MANAGEMENT COMPANY, a California corporation, A. J. GROESBECK FINANCIAL ADVISORS, INC., a California corporation, A. J. GROESBECK ASSOCIATES OF UTAH, INC., a Utah corporation, PETER A. REID, CARLIN, LEVY AND COMPANY, Certified Public Accountants, a partnership, and COMMERCIAL SECURITY BANK, a national banking corporation,

Defendants.

MEMORANDUM OPINION IN LIEU OF FINDINGS OF FACT AND CONCLUSIONS OF LAW

Adam M. Duncan, Esq., Salt Lake City, Utah, for plaintiffs.

William R. Dickerson of Lafollette, Johnson, Horgan & Robinson, Los Angeles, California, and Reed L. Mar-

tineau of Worsley, Snow & Christensen, Salt Lake City, Utah, for defendant Carlin, Levy & Company.

Robert M. Anderson and Jean L. Weaver of VanCott, Bagley, Cornwall & McCarthy, Salt Lake City, Utah, for defendant Commercial Security Bank.

Kenneth W. Yeates of Prince, Yeates, Ward, Miller & Geldzahler, Salt Lake City, Utah, for all other defendants.

The plaintiffs at Salt Lake City, Utah, purchased certain interests in a limited partnership known as Cinco Villa Company, which they allege are securities within the meaning of 15 U.S.C. 78c(a)(1), and contend that the sale of these interests by certain of the named defendants violated Section 10 of the Securities Exchange Act of 1934 and Rule 10b-5, promulgated thereunder. Plaintiffs further allege that defendants Carlin, Levy and Company, Certified Public Accountants, and Commercial Security Bank, were aiders and abetters in the alleged securities fraud, and that certain of the defendant Groesbeck corporations are liable as alter egos of defendant Groesbeck, or as control persons under Section 20 of the Exchange Act of 1933. Plaintiffs also claim damages under common law fraud principles and exemplary damages against certain of the named defendants. Jurisdiction exists under the Securities Exchange Act of 1934, 15 U.S.C. § 78aa, and the pendent jurisdiction of this court.

The matter came before the court, sitting without a jury, for hearing commencing on August 26, 1974. The parties appeared in person and were represented by their respective counsel. Plaintiffs presented their case by documentary evidence and sworn testimony. At the close of the plaintiffs' case, defendant Commercial Security Bank moved to dismiss the action as against it pursuant to Fed. R. Civ. P. 41(b). The court granted the bank's motion

and it was dismissed from the case.[1] A similar motion was made by defendant Carlin, Levy and Company, and this motion was taken under advisement. The cause was submitted to the court for its determination and decision as to the other defendants. This opinion, together with the admitted facts contained in the pretrial order, shall constitute this court's Findings of Fact and Conclusions of Law, as required by Fed. R. Civ. P. 52(a).

FACTS AND BACKGROUND

During 1968 and prior thereto, defendant Arthur J. Groesbeck, III, was employed by Financial Concept, Inc., at Los Angeles, California, as an advisor to professional people in the areas of financial planning and investments. His activities involved generally the organization of limited partnerships in real estate and the sale of interests in those limited partnerships to professional people as an investment and tax shelter. In order to engage in this same type of business activity on his own, Groesbeck organized and/or acquired an interest in a number of business entities in 1968 and 1969.[2]

Jordan M. Carlin and Harvey H. Levy are licensed and practicing Certified Public Accountants and are partners in the Los Angeles accounting firm of Carlin, Levy and Company, one of the defendants herein (hereinafter Carlin-Levy). Commencing in 1967, Carlin-Levy prepared the personal tax returns for Groesbeck, and following the

1. Findings of Fact and Conclusions of Law were filed by the court respecting Commercial Security Bank's dismissal from the case on October 10, 1974.

2. These business entities which are named defendants in this case include Arthur J. Goesbeck Associates, Inc., Griffin Service Corporation, Griffin Properties Corporation, Griffin Securities Corporation, Griffin Business Services Corporation, Compumanagement Company, A. J. Groesbeck Financial Advisors, Inc., and A. J. Groesbeck Associates of Utah, Inc.

organization or acquisition by Groesbeck of the other business entities referred to above, Carlin-Levy also prepared tax returns and did other general accounting work for those entities.

Sometime prior to November 11, 1969, Groesbeck, or the Groesbeck organization, conceived of a limited partnership to be known as "Cinco Villa." On November 11, 1969, Harvey H. Levy received a phone call from an agent or employee of Groesbeck, in which he was requested to render a tax impact opinion letter regarding the deductibility of prepaid interest and losses of the proposed Cinco Villa. It was requested that the opinion letter be prepared on the basis of facts which were related to Levy over the telephone. Based upon the information and assumptions related to him,[3] Levy prepared a tax impact opinion letter, as requested, dated November 13, 1969.[4] The format of this letter was the same as similar letters prepared for the Groesbeck organization for similar ventures, and, although addressed to Groesbeck, the letter was subsequently used by the Groesbeck organization in the marketing and sales of the limited partnership interests. The possibility that the letter would be used in the marketing of limited partnership interests through salesmen was known by Carlin-Levy.

To sell the limited partnership interests in Cinco Villa, the Groesbeck organization's marketing program consisted of postcards, seminars, and personal visits to prospective buyers. Defendant Peter Reid was employed as Director of

3. In the preparation of the tax impact opinion letter, Levy did not make independent verification of the information given to him by the Groesbeck organization, nor did he inspect the properties which were proposed to be purchased for the venture. On November 11, 1969, Cinco Villa was merely proposed and it came into existence later.

4. This letter was plaintiff's Exhibit 4 at trial.

Marketing by the Groesbeck organization during the fall of 1969 and was the organization's primary contact with each of the plaintiffs in the case.[5] Reid conducted seminars and discussions in December, 1969, and in connection therewith printed informational materials were distributed to prospective investors in person and through the mails. Plaintiffs Warr, Hickman, and Poulson each attended one or more of these seminars and each received the written informational materials. Plaintiffs Hickman, Poulson, and Warr received two sales brochures, one dated November 11, 1969 (Trial Exh. P-2), and one dated December 12, 1969 (Trial Exh. P-3). These plaintiffs also received the tax impact opinion letter under the letterhead of Carlin-Levy dated November 13, 1969 (Trial Exh. P-4). Plaintiff Fishler did not attend the seminars or receive any written material prior to signing the partnership agreement on December

5. Each of the plaintiffs is, and at all times material to this action was, a resident and citizen of the State of Utah. Plaintiffs Hickman and Poulson are licensed physicians. Plaintiff Warr is a licensed dentist. Plaintiff Fishler has been engaged in the pharmaceutical and medical supply business. Each of the plaintiffs is well educated and has had some investment experience. It is unnecessary for the court to outline in detail the exact steps which lead up to the investment decision of each plaintiff. Suffice it to say, defendant Peter Reid made three visits to Salt Lake City on December 2, December 16, and approximately December 29, 1969. During such visits Reid met with Warr, Poulson and Hickman and on the last visit with Fishler. Groesbeck made one trip to Utah in October, 1969, and conducted a seminar. In connection with the seminars and the discussions, printed informational materials were distributed to the prospective investors in person and through the mails. Defendants Groesbeck and Reid also talked by telephone during that period with prospective Utah investors.

Plaintiffs Hickman, Warr and Poulson also submitted financial information to A. J. Groesbeck Associates, Inc., for the purpose of obtaining a financial analysis, including the recommendation of suitable investment programs. Plaintiff Fishler did not have any such financial analysis performed. There was no evidence at trial in any way indicating that such financial evaluations were in any way conducted for any purpose other than to make proper and suitable financial and investment recommendations to clients of A. J. Groesbeck Associates, Inc., or that the recommendations were in any way misleading or used for any ulterior purpose.

29, 1969. Fishler did, however, have telephone and personal discussions with Reid on December 29, 1969, in regard to the Cinco Villa venture.[6] The two sales brochures, the tax impact opinion letter, the partnership agreement, and correspondence prepared and distributed by the Groesbeck organization were reviewed by plaintiffs Warr, Poulson and Hickman with their respective accountant (Mr. Osman for Warr and Poulson) and tax attorney (Mr. Jardine for Hickman) prior to making the investment.

CINCO VILLA

The Cinco Villa limited partnership was formed for the purpose of purchasing two apartment complexes located at 11130-32-34 Freeman Avenue and 4846-48 116th Street in Hawthorne, California. These two apartment house complexes are approximately a mile to a mile and a quarter apart from each other and consist of five four-unit buildings with three located at one location and two at the other.[7] On December 29, 1969, all of the plaintiffs herein executed copies of a limited partnership agreement and invested the following amounts:

Grant A. Hickman	$40,000
Stanford E. Poulson	10,000
Newell E. Warr	5,000
Ben M. Fishler	15,000

6. Except for the partnership agreement signed December 29, 1969, Fishler neither saw nor received any other documents or written information on the Cinco Villa venture until the spring of 1970, after he had made his investment.

7. Reid originally viewed and examined the property sometime in November, 1969. Robert Tromblay, an employee of A. J. Groesbeck Associates, Inc., had managed and supervised the property while employed previously by Hawthorne Savings and Loan Company.

On December 31, 1969, the Cinco Villa limited partnership was formed and on that day purchased the Cinco Villa apartment house complexes and paid the sum of $280,000, including broker's commission. Based upon an appraisal in which the market value could be reasonably estimated near the time of the sale, the fair market value of the Cinco Villa complexes closely approximated $280,000. The general partner for the Cinco Villa limited partnership was A. J. Groesbeck Associates of Utah, Inc., organized in December, 1969, but prior to the formation of the limited partnership.[8]

ELEMENTS OF 10b-5

The private right of action under Rule 10b-5 is predicated on a statutory tort theory—a general principle of tort law that violation of a provision of a criminal statute designed to prevent a particular type of harm can give rise to a civil remedy. *Mitchell* v. *Texas Gulf Sulphur Company,* 446 F.2d 90, 97 (10th Cir. 1971). To recover under

8. Subsequent to the formation of the limited partnership, plaintiffs received a picture of one of the apartment complexes and periodic letters under the letterhead of A. J. Groesbeck Financial Advisors for A. J. Groesbeck Associates, Inc. Such letters were signed A. J. Groesbeck, general partner, or A. J. Groesbeck Associates, Inc. of Utah, general partner.

Plaintiffs also received periodic reports from Compumanagement Company indicating the cash position and financial condition of the Cinco Villa limited partnership. For the years 1969, 1970, 1971 and 1972, plaintiffs received partnership income tax returns. Each of the plaintiffs deducted the specified amount of partnership loss attributable to each plaintiff on his own personal income tax returns for each of the indicated years. Defendant's Exhibit D-G-40 at trial indicated that over the four-year period, 1969-1972, each of the plaintiffs received the following total tax savings from his claimed deductions arising from his limited partnership interests in Cinco Villa:

Grant A. Hickman	$21,636.93
Stanford E. Poulson	2,272.99
Newell E. Warr	1,422.32
Ben M. Fishler	6,134.12

the rule it has been repeatedly held that a successful plaintiff must prove (1) the use of the mails or instrumentalities of interstate commerce, (2) the purchase or sale of a security; and (3) the use of a manipulative or deceptive device. *Kerbs* v. *Fall River Industries, Inc.,* 502 F.2d 731, 737 (10th Cir. 1974); *Stevens* v. *Vowell,* 343 F.2d 374, 378 (10th Cir. 1965). The literal fulfillment of these three elements does not, however, guarantee recovery. Although it is not necessary to allege or prove common law fraud to make out a case under Rule 10b-5, the "common law fraud elements—misrepresentation or nondisclosure, materiality, scienter, intent to defraud, reliance and causation—have crept in and played varying roles of significance." *Mitchell* v. *Texas Gulf Sulphur Company,* 446 F.2d, at 97. It is undoubtedly true that

> "[s]ome form of reliance-causation test for damages must remain in the rules . . . in order to prevent the rule from turning defendants into public guarantors of losses wherever a violation of the rule has occurred."[9]

In this Circuit it is clear that materiality,[10] scienter,[11] reliance and causation[12] and damages in connection with a misrepresentation or omission must be shown.

9. Cobine, *Elements of Liability and Actual Damages in Rule 10b-5 Actions,* 1972 LAW FORUM, 651, 684 (1972).

10. *See,* Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 97 (10th Cir. 1971).

11. See Clegg v. Conk, ... F.2d ..... (10th Cir. November 1974) in which the court, after reviewing the relevant Tenth Circuit decisions in the area, stated:

> "From their common principles and applications may be deduced the propositions that there is required something additional by way of scienter or conscious fault than mere negligence, and something more by way of reliance or causation in fact than some abstract wrong expending its force entirely upon itself."

12. *Id.*

THE MATERIALITY OF THE ALLEGED MISREPRESENTATIONS

At trial, plaintiffs claimed misrepresentations or omissions of fact arising from the two sales brochures, dated November 11, 1969 (Exh. P-2) and December 12, 1969 (Exh. P-3), prepared for and used in the sale of the limited partnership, from the tax impact opinion letter (Exh. P-4) prepared by Carlin-Levy, and from the sales seminars and personal discussions held in Salt Lake City by Groesbeck and Reid. Plaintiffs compiled in their post-trial brief a long list of alleged misrepresentations and omissions;[13] however, only two were stressed at trial and only two could reasonably be argued to be material.

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13. The court finds that the following alleged misrepresentations or omissions are not material for the following reasons:

1. In the November 11 and December 12, 1969, sales brochures the representations (a) that employees of A. J. Groesbeck Associates of Utah, Inc., were investing in the property as limited partners, and (b) that Carlin-Levy had been retained as auditors and tax counsel of the venture were not material because reasonable investors would not likely make an investment decision merely on the basis of what employees or functionaries of a corporation do or fail to do, nor would reasonable investors mistakenly assume that the success of an investment is dependent on who serves as auditors or tax counsel.

2. In the November 11 and December 12, 1969, sales brochures the alleged omissions to state (a) that Groesbeck owed (*sic*) 90% of both Griffin Properties Corporation and A. J. Groesbeck Associates, Inc., (b) that the "Table of Benefits" did not state that all of the numbers would change if any of the claimed deductible items were thereafter disallowed by the IRS, (c) that Groesbeck had never seen Cinco Villa, (d) that each limited partner would be subject to further cash calls should the limited partnership require additional funds, (e) that the amount of payments, whether inclusive or noninclusive of interest accrued, and whether payments were to be monthly, quarterly, annual or otherwise, on the first trust deed of $225,000, (f) that the identity of the owner of the second trust deed of $20,000 and consideration therefor was unknown, (g) that there were risks of short-time foreclosures upon late payment or other default, and that there might be possible problems of obtaining refinancing or additional financing where the property was subject to

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First, in both the November 11, 1969, sales brochure and the tax impact opinion letter it is represented that Groesbeck would invest personally and be the general

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Footnote Continued—

two trust deeds, and (h) that there was a prior and continuing relationship between Carlin-Levy and the Groesbeck organization, were not material because (a) common ownership of related corporations is no indication of foul play, (b) it is only common sense that claimed deductible items will change if disallowed by the IRS (however, the evidence shows that all the claimed deductible items were allowed by the IRS in this case), (c) the law does not require that a corporate president personally inspect every detail concerned with his corporation (in this case, Groesbeck's agent and employee inspected the property in question), (d) the subject of further cash calls need not be discussed in promotional material (this was clearly treated in paragraph 13 of the Limited Partnership Agreement, Exh. P-8), (e) this is not material that needs to be specified in promotional or sales material, (f) this is not material that needs to be specified in promotional or sales material, (g) contingent risks (which the evidence fails to show ever occurred) need not be mentioned in promotional or sales material, (h) a relationship between a corporation and its accountants is of little probative value in evaluating an investment possibility, especially in the absence of any evidence of illegal participation.

In the November 13, 1969 Tax Impact Opinion Letter prepared by Carlin-Levy the following are claimed omissions: (a) that the letter was based solely on two telephone conversations and a memo from the Groesbeck organizations, (b) that Carlin-Levy had made no investigation as to the property involved in the letter, (c) that Carlin-Levy had written at least six other similar letters, (d) that Carlin-Levy did not consider themselves qualified tax advisers or tax experts, (e) that Carlin-Levy had never written a tax impact letter for anyone other than the Groesbeck organization, and (f) that Carlin-Levy had performed internal accounting services for all of the Groesbeck corporations. The court finds that these alleged omissions were not material because it is not customary in the accounting profession, when preparing a tax impact letter, to include this type of information because the tax opinion letter was prepared only for a "proposed" limited partnership venture. It was a representation of the tax consequences of prepaid interest and losses and not a warranty on the location or condition of the property. The information in the letter was shown by the evidence to be accurate and the deductions represented were allowed by the IRS.

Plaintiffs have failed to establish by a preponderance of the evidence that the alleged misrepresentations or omissions in this footnote would be material to the investment decision of a man of ordinary prudence and intelligence under the circumstances in this case.

partner of Cinco Villa limited partnership when, in reality, A. J. Groesbeck Association of Utah, Inc., subsequently became the general partner. Although this representation was corrected in the December 12, 1969, sales brochure and in voluminous correspondence subsequent to plaintiffs' investment, this court finds that this representation could have been material to plaintiffs in making their investment decision. That is, as objectively measured against reasonable investors,[14] the plaintiffs' investment judgment was likely influenced by the representation that Groesbeck, a man represented to plaintiffs as being an experienced and successful financial adviser to large numbers of professional people, was personally investing funds in Cinco Villa as the general partner.[15] Second, the tax impact opinion letter used by the Groesbeck organization's sales promotion represented that the property consisted of "a 20-unit apartment building" rather than representing the property as located in two different locations.[16] The Court is unable to say that this misrepresentation was material. Reasonable investors, without the hindsight that plaintiffs now have that two separate lo-

14. SEC v. Texas Gulf Sulphur Co., 446 F.2d 90, 97 (10th Cir. 1971).

15. The court does not reach this conclusion without considerable hesitation, especially in light of plaintiffs' subsequent inaction upon discovering for certain that Groesbeck was not the general partner.

It seems that if the representation that Groesbeck was going to personally invest in Cinco Villa as general partner was of primary significance in the plaintiffs' investment decision, (as they testified it was) it is almost inconceivable that they did not protest upon their discovery of the truth, which at the latest would have been April, 1970, when each of the plaintiffs received from Cinco Villa the necessary information to file his 1969 income tax return. However, the court does not feel that this fact alone justifies a conclusion that this representation was not material at the time the investment decision was made in December, 1969.

16. Despite the language "a 20-unit apartment building" the tax impact letter listed both addresses of the two separate complexes.

cations might cause additional management and supervisorial problems, would not likely be influenced in their investment decision by the fact that the twenty apartment units were at two different, although proximate, locations.

SCIENTER

Scienter or "conscious fault"[17] is easily found in this case. Groesbeck indisputably distributed sales material and reports on the Cinco Villa venture representing himself as becoming the general partner when the limited partnership was organized. Before the execution of the partnership agreement, as well as after the investments were made, Groesbeck corresponded with plaintiffs, signing his name as Cinco Villa's general partner. Without doubt Groesbeck knew that he was misrepresenting this fact.

RELIANCE AND CAUSATION[18]

The Circuit Court of Appeals has repeatedly expressed the requirement that "the plaintiff must . . . exercise good

17. *See* Footnote 11, *supra.*

18. Undoubtedly the area of federal securities litigation is better off for not analyzing cases in terms of proximate cause. However, with the White v. Abrams, 495 F.2d 724 (9th Cir. 1974) duty analysis in the Ninth Circuit and the brief discussion of "cause in fact" in the recent Tenth Circuit decision of Clegg v. Conk, ... F.2d ..... (10th Cir. November, 1974), it seems appropriate to conceptually relate the two approaches with the following observations:

Causation is an essential element of any tort action. Properly considered, it has two elements: cause in fact and proximate cause. Cause in fact embraces both positive acts and passive conditions which have so contributed to the result that without them it would not have occurred. Cause in fact is often expressed as the "but for" test, and courts have felt a need to limit the "but for" test in its application. Materiality has often been a limiting factor in this test, and, as such, the test can be stated in broader terms as: "The defendant's conduct is a cause

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faith in its purchase, due diligence, and demonstrate reliance on the acts or inaction of the defendant"[19] to recover in Rule 10b-5 actions. Reliance and causation are very closely related in some cases. In *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d, at 101-02, the court stated that "the cases have deemed the 'connection' requirement fulfilled" if the defendant has uttered false or misleading statements concerning the securities in question, upon which the plaintiff has relied. This use of the concept of reliance as a means of finding a connection introduces the factor of causation. Thus, a plaintiff could rely on a material misrepresentation or omission which would cause him to purchase or sell a security. If the misrepresentation concerned the value of the security, then the damage could be said to occur when the purchase or sale was made. In this example, materiality, reliance and causation would be closely related sequentially. The materiality and reliance

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Footnote Continued—

of the event if it was a material element and a substantial factor in bringing it about." W. Prosser, Law of Torts 240 (4th ed. 1971). "Under Rule 10b-5, the materiality and reliance requirements are best classified as cause in fact elements." Cobine, *supra* Note 9, at 656.

Proximate cause is a far more complex question because it involves questions of legal policy. "It has been suggested that the question of proximate cause is not really a question of causation at all, but rather a question of whether the defendant was under a duty to the plaintiff, or whether defendant's duty required him to protect plaintiff from the event which did in fact occur." Cobine, *supra*, Note 9 at 653. The proximate cause or duty question is answered in 10b-5 litigation by the rule itself: the defendant should not commit any of the acts proscribed in the rule in connection with the purchase or sale of any security.

Cause in fact and proximate cause (duty) are not new concepts in tort analysis. Both cause in fact and duty must be determined in each case. A tort analysis approach which stresses either one cannot properly decide a case at the total exclusion of the other.

19. Financial Indus. Fund, Inc. v. McDonnell Douglas Corp., 474 F.2d 514, 517 (10th Cir. 1973), *citing* Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90 (10th Cir. 1971) and Gilbert v. Nixon, 429 F.2d 348 (10th Cir. 1970).

could be said to have (1) caused both the decision to buy or sell and the damages, because (2) the value of the security was misrepresented and the (3) damages resulted merely from either the purchase or the sale. Unlike this hypothetical case, however, in the instant case it is necessary to make a distinction between reliance on the misrepresentations as they caused the investment decision and the misrepresentations as the cause of the damages sustained. The court finds that plaintiffs, in making their decision to invest, relied on the misrepresentation that Groesbeck would be Cinco Villa's general partner and that he would be personally investing in the venture.[20] The court is unable to conclude, however, that this misrepresentation was in any way connected to the damages claimed by plaintiffs. Although the misrepresentation was material and although it was relied upon by plaintiffs in making their decision to invest, the securities that were purchased were equal in value to the amount paid for them. It has not been shown that Groesbeck's misrepresentation in any way caused plaintiffs' alleged damages. That is, Groesbeck was under no duty which required him to protect plaintiffs from the events which did in fact cause

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20. The court concludes that although three of the plaintiffs had their own advisers review the information concerning the proposed venture that reliance can still be found since the advisers could have also relied on the alleged misrepresentations. The court, however, is unable to say, in view of the evidence presented, that plaintiffs' reliance was justified under the facts of this case. The location of the buildings and the identity of the general partner were inconsistently represented in the promotional material. If the contradictions and inconsistencies in the promotional material were so insignificant as not to be noted by the plaintiffs, then it is likely that plaintiffs relied on something other than the written materials. Of course, they could have relied totally on oral representations. The evidence showed that on December 29, 1969, and prior thereto, plaintiffs were so anxious to complete negotiations for income tax shelters that they recklessly ignored and disregarded much pertinent information supplied to them concerning Cinco Villa. At trial, each of the plaintiffs was, as to certain material facts testified to by him, uncertain, vague and contradictory.

the alleged damages.[21] This distinction is explained in applying the "out-of-pocket" theory of damages.

DAMAGES

Although there exists no rigid law of damages under Rule 10b-5,[22] actual damages based on the Securities Exchange Act of 1934 are measured by the "out-of-pocket rule." In *Estate Counseling Service* v. *Merrill Lynch, Pierce, Etc.*, 303 F.2d 527, 533 (10th Cir. 1962) the court stated:

> The failure to show actual damages is also a fatal defect in the cause of action based on the Securities Exchange Act of 1934, 15 U.S.C. § 78a et seq. That Act permits recovery of "his actual damages on account of the act complained of." "Actual damages," under the Federal rule of damages for fraud is the "out of pocket rule." In the Federal courts the measure of damages recoverable by one who through fraud or misrepresentation has been induced to purchase bonds or corporate stock, is the difference between the contract price, or the price paid, and the real or actual value at the date of the sale, together with such outlays as are attributable to the defendant's conduct. Or in other words, the difference between the amount parted with and the value of the thing received. [Citations omitted.]
>
> According to this theory, the question is not what the plaintiff might have gained, but what he has lost by being deceived into the purchase; the defendant is liable to respond in such damages as naturally and proximately result from the fraud; he is bound to make good the loss sustained—such moneys as the plaintiff has paid out, with interest, and any other outlay legitimately attributable to the defendant's fraudulent conduct—but this liability does not include the expectant fruits of an unrealized speculation.

21. *See* Note 24 infra.

22. In Mitchell v. Texas Gulf Sulphur, 446 F.2d 90, 105 (10th Cir. 1971) the court stated:

> [B]ecause of the uniqueness of the litigation, it would be unwise to set forth a uniform rule [of damage awards] with broad applications to all securities cases.

The sales materials (Exhibits 2, 3 and 4) represented the purchase price of the Cinco Villa apartment complexes to be $280,000—the price the limited partnership ultimately paid for them. The apartment complexes had a market value equal to the $280,000 purchase price paid for them in late December, 1969, and they substantially retained such value thereafter as evidenced by plaintiffs' own appraiser's report obtained in December, 1971. Plaintiffs presented no evidence to show that there was any discrepancy between the price paid and the actual value at the date of the sale. This failure to show actual damages based upon the out-of-pocket rule as set forth above is a fatal defect in plaintiffs' case.

Plaintiffs' complaint invalidly seeks a rescission remedy by claiming, contrary to the evidence, that the investment was totally worthless. When rescission is sought in actions of this nature, there is a promptness rule which requires the plaintiff to seek rescission as soon as fraud or misrepresentation is discovered. In *Estate Counseling Service* v. *Merrill Lynch, Pierce, Etc., supra* at 532, the court stated:

> In view of the speculative nature of the transaction and with a fluctuating market, the law required the appellant to act promptly or waive its right to rescind. Where parties have the right to rescind, they cannot

> delay the exercise of that right to determine whether avoidance or affirmance will be more profitable to them. This is particularly true where the transaction is one of a speculative nature. [Citations omitted.] So also where a party desires to rescind upon the grounds of misrepresentation or fraud he must, upon discovery of the fraud, announce his purpose and adhere to it.

Construing the evidence most favorably to plaintiffs' position, all plaintiffs had notice of the alleged misrepresentations by March or April of 1970 when they received from Cinco Villa the necessary information to file their 1969 income tax returns. In general, courts have been wary of claims for rescission, restitution, and equivalent damages in 10b-5 litigation.[23] To award such a remedy in this case, in which plaintiffs have delayed action for over two years after learning of the alleged misrepresentations, would allow plaintiffs to reap significant tax benefits while speculating on the future of their venture and then return to them the value of their initial investment when the venture failed. The securities laws contemplate no such investment guarantee. The basis of the requirement of immediacy of action by one who seeks rescission is the prevention of speculation. The radical relief sought by plaintiffs in this action is denied.[24]

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23. Cobine, *supra* Note 9, at 670.

24. Counsel for defendants argued that the Cinco Villa venture failed because of possible mismanagement, rent and price controls, and the state of economy which influenced tenancy, etc. Although these arguments were poorly documented with evidence, plaintiffs did not offer evidence in opposition. Whatever the reason for the failure of the Cinco Villa venture, plaintiffs offered no evidence connecting the failure (which is the real measure of plaintiffs' damages, if any) with any of the alleged misrepresentations.

COMMON LAW FRAUD

> The law of Utah is well settled as to the necessary elements of a common law action for fraud and deceit. Those elements are: (1) a representation; (2) its falsity; (3) its materiality; (4) the speaker's knowledge of its falsity or ignorance of its truth; (5) his intent that it should be acted upon by the person and in the manner reasonably contemplated; (6) the hearer's ignorance of its falsity; (7) his reliance upon its truth; (8) his right to rely thereon; (9) his consequent and proximate injury. [Citation]. *Estate Counseling Service* v. *Merrill Lynch, Pierce, Etc.*, 303 F.2d 527, 532 (10th Cir. 1962).

Plaintiffs failed to prove these necessary elements by a preponderance of the evidence. Not unlike an action based on the Securities Exchange Act of 1934, "[a]ctions for fraud have failed because of lack of proof of damages." *Id.*

CARLIN-LEVY

Carlin, Levy and Company, Certified Public Accountants, are charged by plaintiffs as aiders and abetters in the alleged securities fraud primarily due to the tax impact opinion letter that was used in the sales of the limited partnership interests. The alleged misrepresentations in the tax impact letter concerned the location of the apartment complexes and represented Groesbeck as the general partner. At the close of the plaintiffs' case, Carlin-Levy moved to dismiss the action as against it pursuant to Fed. R. Civ. P. 41(b). This motion was taken under advisement at that time.

The court is well aware that *Kerbs* v. *Fall River Industries, Inc.*, 502 F.2d 731 (10th Cir. 1974) states that

under Rule 10b-5, "knowing assistance of or participation in a fraudulent scheme gives rise to liability equal to that of the perpetrators themselves" and that "one who aids and abets a fraudulent scheme may be held accountable even though his assistance consists of mere silence or inaction." *Id.* at 740. However, plaintiffs have failed to prove by a preponderance of the evidence that Carlin-Levy either knew of the alleged fraudulent scheme or knew of the alleged misstatements in the tax opinion letter when issued. Rather, the evidence shows that the misrepresentation given to Mr. Levy by the Groesbeck organization on November 11, 1974, that Groesbeck was to be the general partner of Cinco Villa, accurately reflected the expectations of the Groesbeck organization as of that date. The subsequent change in the proposed general partner which resulted when A. J. Groesbeck Associates of Utah, Inc., was organized in December, 1969, could not have been reflected in the November 13, 1969, opinion letter. Plaintiffs have failed to present convincing evidence showing that Carlin-Levy could reasonably have been expected to know of the alleged fraudulent scheme. Therefore, Carlin-Levy's motion to dismiss is now granted and it is dismissed from the case.

No evidence was adduced at trial that would enable the court to make a separate finding concerning the liability of Peter Reid, the Groesbeck agent in Utah. Reid's liability is therefore determined in conjunction with Groesbeck and the Groesbeck organizations. The record is not clear whether some of the defendants are presently named as parties in bankruptcy proceedings in California. Judgment in this case, therefore, should be entered subject to modification if it is subsequently shown that all actions against any of the defendants have been stayed.

Based upon the foregoing, judgment should be rendered for defendants, no cause of action on plaintiffs' complaint.

DATED this 18th day of December, 1974.

/s/ Aldon J. Anderson
Aldon J. Anderson
United States District Judge